

THE OFFICE OF REGULATORY STAFF

DIRECT TESTIMONY

OF

CHRISTINA L. SEALE

APRIL 16, 2009



DOCKET NO. 2009-12-S

**Application of Aqua South Carolina, Inc. for
Approval of a New Schedule of Rates and
Charges for Sewerage Services Provided to
Customers in Spartanburg County**

DIRECT TESTIMONY OF CHRISTINA L. SEALE

FOR

THE OFFICE OF REGULATORY STAFF

DOCKET NO: 2009-12-S

IN RE: APPLICATION OF AQUA SOUTH CAROLINA, INC.

FOR APPROVAL OF A NEW SCHEDULE OF RATES AND CHARGES

FOR SEWERAGE SERVICES PROVIDED TO CUSTOMERS

IN SPARTANBURG COUNTY

**Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND
OCCUPATION.**

A. My name is Christina L. Seale. My business address is 1401 Main Street,
Suite 900, Columbia, South Carolina, 29201. I am employed by the South
Carolina Office of Regulatory Staff ("ORS") as an auditor.

**Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND
EXPERIENCE.**

A. I received a Bachelor of Science Degree with a major in accounting and a
minor in computer systems and applications from Columbia College in 2000.
From 2000 to 2004, I was employed by the South Carolina Office of the State
Auditor. In that capacity, I performed agreed-upon procedures engagements and
statewide single audits of various state agencies in South Carolina. In January
2005, I began my employment with ORS.

**THE OFFICE OF REGULATORY STAFF
1401 Main Street, Suite 900
Columbia, SC 29201**

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY IN THIS PROCEEDING?

A. The purpose of my direct testimony is to set forth my findings and recommendations resulting from ORS's examination of the application, filed on January 2, 2009, of Aqua South Carolina, Inc. for approval of a new schedule of rates and charges for sewerage services provided to customers.

Q. PLEASE IDENTIFY THE EXHIBITS ATTACHED TO YOUR DIRECT TESTIMONY.

A. I have attached the following exhibits to my direct testimony relating to the application:

- Audit Exhibit CLS-1: Operating Experience and Operating Margin
- Audit Exhibit CLS-2: Explanation of Adjustments
- Audit Exhibit CLS-3: Computation of Depreciation Expense
- Audit Exhibit CLS-4: Computation of Income Taxes

These exhibits were either prepared by me or were prepared under my direction and supervision in compliance with recognized accounting and regulatory procedures for wastewater utility rate cases.

Q. PLEASE DESCRIBE THE FORMAT OF AUDIT EXHIBIT CLS-1 AND ELABORATE ON THE CALCULATIONS.

A. Audit Exhibit CLS-1 shows Aqua South Carolina, Inc.'s ("Aqua SC" or "Applicant") operating experience and operating margin for wastewater operations for the test year ended June 30, 2008. The exhibit's format is designed to reflect the application per books and ORS's proposed accounting and pro forma

1 adjustments necessary to normalize the results of the Applicant's test year
2 operations.

3 Column (1) shows the application per books filed by Aqua SC for the test year
4 ended June 30, 2008. The net operating loss of (\$36,836) was based on total
5 operating revenues of \$99,283 less total operating expenses of \$136,119. The net
6 operating loss less interest expense of \$5,620 resulted in a total loss for return of
7 (\$42,456). The operating margin of -42.76% was calculated by dividing the total
8 loss for return by the total operating revenues.

9 Column (2) shows ORS's proposed accounting and pro forma adjustments
10 necessary to normalize the application per books for rate making purposes. An
11 explanation of each adjustment is contained in Audit Exhibit CLS-2.

12 Column (3) shows ORS's calculation of a normalized test year for Aqua SC by
13 adding columns (1) and (2). The net effect of ORS's proposed accounting and
14 pro forma adjustments resulted in total loss for return of (\$38,412) and an
15 operating margin of -38.27%.

16 Column (4) reflects the Applicant's proposed increase and the calculation of
17 billing fees, bad debt and taxes associated with the proposed increase. An
18 explanation of each adjustment is contained in Audit Exhibit CLS-2.

19 Column (5) shows the effect of the Applicant's proposed rate increase by adding
20 columns (3) and (4). The Applicant's proposed rate increase would result in total
21 income for return of \$49,004 and an operating margin of 23.42%.

22 **Q. PLEASE EXPLAIN THE ADJUSTMENTS IN AUDIT EXHIBIT CLS-2.**

23 **A.** For comparative purposes, ORS and Applicant's adjustments are both

presented in Audit Exhibit CLS-2. The following adjustments are listed at Audit Exhibit CLS-2 under "Adj. #".

Adjustment 1 – ORS proposes to adjust sewer revenues to reflect actual customer units. Details of this adjustment are shown on Exhibit MEF-3 of ORS Water/Wastewater Specialist, Elizabeth Ford.

Adjustment 2 – ORS proposes to reverse a payroll credit accrual per book of \$2,572 for the previous year. Also, ORS proposes to remove the salaries, wages and benefits of (\$439) from expenses. These services are provided by Aqua SC's management company and are included in O&M Management expenses. ORS's total adjustment was for \$2,133.

Adjustment 3 – ORS proposes to reclassify training costs of (\$15) to O&M Management expenses.

Adjustment 4 – ORS proposes to adjust wastewater treatment costs for the actual gallons treated from a modified usage report. ORS calculated a difference of 2,838,761 gallons and applied the current rate of \$.00361 for treatment and transportation costs per gallon. The resulting amount was an adjustment of (\$10,248).

Adjustment 5 – ORS proposes to adjust wastewater treatment costs to reflect an increase in the treatment and transportation rate. ORS calculated total treatment cost of \$103,685 using 26,203,039 gallons and the current rate of \$.003957 per gallon. Total treatment cost less the per book amount of \$94,106 resulted in an adjustment of \$9,579.

1 Adjustment 6 – ORS proposes to remove (\$718) in double booked computer
2 services expenditures.

3 Adjustment 7 – ORS proposes to remove legal fees of (\$2,926) that were not
4 supported by adequate documentation.

5 Adjustment 8 – ORS proposes to adjust the billing fee charged by Startex Jasper
6 Welford Duncan Water District (“SJWD”) to reflect the actual billing collections
7 for the test year. Per agreement, SJWD charges the Applicant seven percent (7%)
8 of actual collections as a fee to bill and collect from the Aqua SC’s customers.
9 ORS calculated the actual collections for the test year of \$100,133 using the total
10 revenues of \$100,368 less bad debt expense of \$235. ORS calculated a total
11 billing fee of \$7,009 less the per book amount of \$6,844 resulting in an
12 adjustment of \$165.

13 Adjustment 9 – ORS proposes to remove expenses from O&M Management of
14 (\$13,425) related to possible acquisitions by the Applicant of other businesses.

15 Adjustment 10 – ORS proposes to reclassify training costs of \$15 recorded as
16 Salaries, Wages and Benefits to O&M Management expenses.

17 Adjustment 11 – ORS proposes to remove expenses from Other of (\$464) related
18 to possible acquisitions by the Applicant of other businesses.

19 Adjustment 12 – ORS proposes to remove prior rate case expenses of (\$12,668).
20 These costs were deferred expenses to prepare a previous application that was not
21 filed.

22 Adjustment 13 – ORS proposes to remove (\$163) in late fees associated with the
23 payment of the 2007 gross receipt taxes.

1 Adjustment 14 – ORS proposes to remove gross receipt taxes of (\$692) that were
2 incurred in 2007, but paid during the test year.

3 Adjustment 15 – ORS proposes to annualize depreciation expense for plant-in-
4 service and amortize contributions in aid of construction (“CIAC”) as of June 30,
5 2008. Depreciation expense reflects useful lives recommended by the ORS
6 Water/Wastewater Department. ORS calculated net depreciation expense for Aqua
7 SC of \$3,223, less the per application depreciation expense of \$3,641, for a total
8 adjustment of (\$418) as shown on Audit Exhibit CLS-3.

9 Adjustment 16 – ORS proposes to amortize rate case expenses incurred in this
10 rate case proceeding. ORS verified actual rate case expenses of \$20,448
11 documented as of March 31, 2009 and amortized over a three-year period for an
12 annual expense of \$6,816.

13 Adjustment 17 – ORS proposes to adjust the gross receipts taxes associated with
14 the revenues after ORS’s accounting and pro forma adjustments. ORS multiplied
15 total operating revenues of \$100,368 by the gross receipts factor of .0074178 for
16 \$745. This amount less the per book amount of \$720, resulted in an adjustment of
17 \$25.

18 Adjustment 18 – ORS proposes to remove (\$50) in state license fees for 2006 and
19 2007 paid during the test year.

20 Adjustment 19 – ORS proposes to remove the effect of negative income taxes of
21 \$22,177.

22 Adjustment 20 – ORS proposes to synchronize interest expense with the
23 Applicant’s investment in rate base. This method allows a utility to recover

1 interest on debt which could be attributed to investment in plant. ORS computed a
2 rate base of \$124,852. ORS used the parent company's capital structure as of
3 December 31, 2007 and allocated the rate base 55.45% to debt and 44.55% to
4 equity. The parent company's capital structure consisted of long-term debt of
5 \$1,215,053 and total owner's equity of \$976,298. ORS computed \$69,230 for the
6 portion of rate base supported by long-term debt ($\$124,852 \times 55.45\%$). ORS then
7 applied the annualized loan interest rate of 5.11% to the long-term-debt portion of
8 \$69,230. ORS calculated annual interest expense of \$3,538, less the per
9 application amount of \$5,620, for an adjustment of (\$2,082).

10 Adjustment 21 – ORS proposes to adjust sewer revenues for the Applicant's
11 proposed increase of \$108,838. Details of this adjustment are shown on Exhibit
12 MEF-3 of ORS Water/Wastewater Specialist, Elizabeth Ford.

13 Adjustment 22 – ORS proposes to adjust the billing fee charged by SJWD to
14 reflect actual collections associated with the Applicant's proposed increase. ORS
15 calculated actual collections of \$108,580 using total revenues of \$108,838 less
16 bad debt expense of \$258. ORS then applied the seven percent (7%) fee to the
17 actual collections of \$108,580, for an adjustment of \$7,601.

18 Adjustment 23 – ORS proposes to adjust bad debt expenses associated with the
19 Applicant's proposed increase. ORS applied a bad debt expense factor of .00237,
20 provided by ORS Water/Wastewater Specialist, Ms. Ford to the Applicant's
21 proposed increase of \$108,638 for an adjustment of \$258.

Adjustment 24 – ORS proposes to adjust gross receipts taxes associated with the Applicant's proposed increase. ORS multiplied the Applicant's proposed increase of \$108,838 by the gross receipts factor of .0074178 for an adjustment of \$807.

Adjustment 25 – ORS proposes to adjust income taxes associated with the applicant's proposed increase as shown on Audit Exhibit CLS-4.

Q. PLEASE DESCRIBE THE REMAINING AUDIT EXHIBITS.

A. Audit Exhibit CLS-3 shows the computation of the depreciation expense adjustment. Plant assets were depreciated and CIAC was amortized based on the useful lives recommended by the ORS Water/Wastewater Department. Audit Exhibit CLS-4 shows ORS's computation of the state and federal income taxes based on taxable income after the Applicant's proposed increase.

Q. WHAT IS THE RESULTING OPERATING MARGIN AFTER APPLYING ORS'S CALCULATION OF THE APPLICANT'S PROPOSED RATE INCREASE?

A. Based on ORS's proposed accounting and pro forma adjustments and after the Applicant's proposed increase, the resulting operating margin is 23.42%, as shown on Audit Exhibit CLS-1.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes it does.

Aqua South Carolina, Inc.
Docket No. 2009-12-S
Operating Experience and Operating Margin
For the Test Year Ended June 30, 2008

	(1)	(2)	(3)	(4)	(5)
	Application Per Books	ORS's Proposed Accounting & Pro forma Adjustments	After ORS's Proposed Accounting & Pro forma Adjustments	Applicant's Proposed Increase	After Applicant's Proposed Increase
<u>Operating Revenues</u>					
Sewer Service	99,283	1,085 (A)	100,368	108,838 (K)	209,206
<u>Total Operating Revenues</u>	\$ 99,283	\$ 1,085	\$ 100,368	\$ 108,838	\$ 209,206
<u>Operating Expenses</u>					
Salaries, Wages & Benefits	\$ (2,118)	\$ 2,118 (B)	\$ 0	\$ 0	\$ 0
Contractual Services - A&G	116,116	(4,148) (C)	111,968	7,601 (L)	119,569
O&M Management	25,542	(13,410) (D)	12,132	0	12,132
Other	14,085	(13,987) (E)	98	0	98
Bad Debt	235	0	235	258 (M)	493
Depreciation	3,641	(418) (F)	3,223	0	3,223
Rate Case	0	6,816 (G)	6,816	0	6,816
Other Taxes	795	(25) (H)	770	807 (N)	1,577
Income Taxes (State and Federal)	(22,177)	22,177 (I)	0	12,756 (O)	12,756
<u>Total Operating Expenses</u>	\$ 136,119	\$ (877)	\$ 135,242	\$ 21,422	\$ 156,664
<u>Net Operating Income (Loss)</u>	\$ (36,836)	\$ 1,962	\$ (34,874)	\$ 87,416	\$ 52,542
Less: Interest Expense	5,620	(2,082) (J)	3,538	0	3,538
<u>Total Income (Loss) for Return</u>	\$ (42,456)	\$ 4,044	\$ (38,412)	\$ 87,416	\$ 49,004
<u>Operating Margin</u>	<u>-42.76%</u>		<u>-38.27%</u>		<u>23.42%</u>

Aqua South Carolina, Inc.
Docket No. 2009-12-S
Explanation of Adjustments
For the Test Year Ended June 30, 2008

Revenues and Expenses	Adj.#	Description	\$ ORS	\$ Applicant
<u>ORS's Proposed Accounting and Pro forma Adjustments</u>				
(A) Sewer Service	1	To adjust sewer revenues to reflect actual customer units.	1,085	1,085
(B) Salaries, Wages & Benefits	2	To reverse a payroll credit accrual and remove salaries, wages and benefits. These services are provided by Aqua SC's management company.	2,133	2,201
	3	To reclassify training costs more appropriately charged to O&M Management expenses.	(15)	0
		Total Salaries, Wages & Benefits Adjustment	2,118	2,201
(C) Contractual Services - A&G	4	To reflect cost of wastewater gallons treated per a modified usage report.	(10,248)	(10,248)
	5	To reflect an increase in wastewater treatment charges.	9,579	9,579
	6	To remove a double booked account.	(718)	0
	7	To remove unsupported expenses.	(2,926)	0
	8	To adjust the fee charged by SJWD for actual billing collections during the test year.	165	0
		Total Contractual Services - A&G Adjustment	(4,148)	(669)
(D) O&M Management	9	To remove costs associated with possible acquisitions.	(13,425)	(13,889)
	10	To reclassify training costs previously charged to Salaries, Wages & Benefits.	15	0
		Total O&M Management Adjustment	(13,410)	(13,889)
(E) Other	11	To remove costs associated with possible acquisitions.	(464)	0
	12	To remove prior rate case expenses.	(12,668)	(12,668)
	13	To remove late fees.	(163)	(163)
	14	To remove taxes incurred outside the test year, but included in the cost of service.	(692)	0
		Total Other Adjustment	(13,987)	(12,831)
(F) Depreciation	15	To adjust depreciation on all plant in service.	(418)	0
(G) Rate Case	16	To amortize rate case expenses of \$20,448 over a three-year period.	6,816	6,667
(H) Other Taxes	17	To adjust the gross receipts taxes associated with the revenues after ORS's accounting and pro forma adjustments.	25	9
	18	To remove license fees incurred outside the test year, but included in the cost of service.	(50)	0
		Total Other Taxes	(25)	9

Aqua South Carolina, Inc.
Docket No. 2009-12-S
Explanation of Adjustments
For the Test Year Ended June 30, 2008

Revenues and Expenses	Adj.#	Description	\$ ORS	\$ Applicant
<u>ORS's Proposed Accounting and Pro forma Adjustments (Continued)</u>				
(I) Income Taxes (State & Federal)	19	To remove the effect of negative income taxes.	22,177	7,501
(J) Interest	20	To synchronize interest expense with the Company's investment in plant.	(2,082)	0
<u>Applicant's Proposed Increase Recalculated by ORS</u>				
(K) Sewer Service	21	To adjust sewer revenues for the Applicant's proposed rate increase.	108,838	108,838
(L) Contractual Services - A&G	22	To adjust SJWD District fee based on the Applicant's proposed rate increase.	7,601	7,695
(M) Bad Debt	23	To adjust the bad debt expense to reflect the Applicant's proposed rate increase.	258	259
(N) Other Taxes	24	To adjust gross receipts taxes associated with the Applicant's proposed rate increase.	807	886
(O) Income Taxes (State & Federal)	25	To adjust income taxes using net income after the Applicant's proposed increase.	12,756	38,250

Aqua South Carolina, Inc.
Docket No. 2009-12-S
Computation of Depreciation Expense
For the Test Year Ended June 30, 2008

<u>Date</u>	<u>Description</u>	<u>Cost</u>	<u>Service</u> <u>Life</u>	<u>Rate</u>	<u>Expense</u>	<u>Accumulated</u>
<u>Acquired</u>		<u>\$</u>	<u>years</u>	<u>%</u>	<u>\$</u>	<u>\$</u>
<u>Assets Per Application:</u>						
9/2004	Collection Sewers - Gravity Account 36120	121,173	40	2.50%	3,029	15,145
4/2003	Elder Valve Account 36120	529	35	2.86%	15	90
9/2005	Office Furniture and Equipment Account 39070	1,281	6	16.67%	214	856
5/2001	Misc. Equipment (Manhole: Rings and Covers) Account 39770	<u>1,272</u>	27	3.70%	<u>47</u>	<u>376</u>
	Total Assets	124,255			3,305	16,467
<u>Contributions in Aid of Construction ("CIAC") Per Application:</u>						
9/2004	Services to Customer/Elder Valve Account 36320	<u>(2,879)</u>	35	2.86%	<u>(82)</u>	<u>(410)</u>
	Net Plant	<u>121,376</u>			<u>3,223</u>	<u>16,057</u>
Net Depreciation Expense for Test Year					3,223	
Less: Per Application Depreciation Expense					<u>3,641</u>	
ORS's Proposed Depreciation Expense Adjustment					<u>(418)</u>	

Aqua South Carolina, Inc.
Docket No. 2009-12-S
Computation of Income Taxes
For the Test Year Ended June 30, 2008

Description	After Applicant's Proposed Increase
Total Operating Revenues	\$ 209,206
Less: Operating Expenses	143,908
Less: Interest Expense	<u>3,538</u>
State Taxable Income	61,760
Less: State Income Taxes @ 5%	<u>3,088</u>
Federal Taxable Income	58,672
Federal Income Taxes:	
1st \$50,000 @ 15%	7,500
Remaining Balance @ 25%	<u>2,168</u>
Total Federal Income Taxes	9,668
Total State and Federal Income Taxes	<u>\$ 12,756</u>